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IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 964.

AMY ARZT and JOSEPHINE RAMSEY,
Petitioners,

against

RUDOLPH B. FLERSHEM, et al., as Reorganization Committee, etc., BANKERS TRUST COMPANY, as Trustee, NATIONAL RADIATOR CORPORATION (Delaware), NATIONAL RADIATOR CORPORATION (Maryland), ROBERT S. WATERS and WILLIAM G. HEINER, as Receivers, etc., and CARL E. RESLEY and G. FRANKLIN LUDINGTON,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF ON BEHALF OF RESPONDENTS RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS AND FRANK B. CAHN, as the Reorganization Committee constituted under the Plan and Agreement dated February 11, 1931, for the Reorganization of National Radiator Corporation.

LAWRENCE BENNETT,
MAYNARD TEALL,
G. FRANKLIN LUDINGTON,
Counsel for the Respondents.

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Opinions of the Courts Below.

The opinion of the Circuit Court of Appeals for the Third Circuit is not yet reported, but printed copies have been filed with the Record. The opinions of the District Court are not yet reported, but appear at pages 416 and 691 of the Record.

Jurisdiction.

The jurisdiction of this Court rests on § 240a of the Judicial Code as amended by Act of February 13, 1925, c. 229, § 1, 43 Stat. 938 (28 U. S. C. A. § 347a).

Introductory Statement.

The present petition is one of three applications by holders of approximately 2% in aggregate of the total outstanding indebtedness of National Radiator Corporation for a writ of certiorari to review a decision of the United States Circuit Court of Appeals for the Third Circuit filed March 24, 1933, affirming a final decree of sale and the decree confirming the sale of the property of the debtor corporation, in a suit instituted in the United States District Court for the Western District of Pennsylvania by the respondents as holders, under a Reorganization Plan, of more than 95% of the total outstanding indebtedness of said corporation. The two other applications are entitled, respectively, "First National Bank of Cincinnati and International Heater Company, Petitioners, against Rudolph B. Flershem, et al., as the Reorganization Committee, etc., and others, Respondents," at Nos. 962-963, and "Lily Clapier, Petitioner, against Rudolph B. Flershem, et al., as the Reorganization Committee, etc., and National Radiator Corporation, Respondents," at No. 965. In the latter application counsel for the present petitioners presents through a dependent suit substantially the same questions presented here.

Since 1928, the continued decline in residential building (R. 208), which utilized the greater part of the debtor's product (R. 207), had resulted in losses for the debtor cor-

poration of around $1,250,000 or $1,300,000 a year (R. 209), reflected in the market quotations for the debtor's outstanding Debentures which by the middle of 1930 were quoted at 20 and reached a low of 14 in the latter part of that year (R. 205). With such losses, it was apparent that, if interest and sinking fund charges amounting to $1,107,852 a year were continued, it was only a matter of a short time before all cash resources of the debtor would be utterly exhausted; insolvency in every sense of the word was inevitable; and, at the time the bill was filed, was imminent. The imminency of insolvency has been fully proved by the subsequent events. By February 1932, the debtor was insolvent in every sense of the word.

That the debtor's predicament was fully appreciated by the public interested in its securities is also shown by the market quotations alluded to. Although the debtor corporation did actually default in the payment of interest February 1, 1931 (R. 49), for more than eight months, until October, receivership — always a costly and detrimental proceeding — was avoided because of the ready acceptance which the Reorganization Plan met from the overwhelming majority of creditors (R. 516-517 et seq.). Receivership ultimately occurred, with the appointment of receivers October 9, 1931 (R. 95), because actions at law had been brought in New York and others were threatened on behalf of the real parties in interest represented by these petitioners (R. 594), to procure preferential payment of their coupons. The verified bill of complaint of the respondents Reorganization Committee properly and correctly stated that the defendant debtor had no means at hand "with which to meet, pay or satisfy the interest charges on the Debentures overdue as aforesaid, without

seriously jeopardizing the ability of the defendant to continue its business and without making it difficult or impossible for the defendant to secure necessary supplies, materials and labor to continue the operation of its plants and the sale of its products" (R. 16) and that the appointment of receivers was imperative, to prevent "a multiplicity of suits, a race of diligence, wasteful strife and controversy" (R. 17). Upon these jurisdictional grounds rested the District Court's decree appointing receivers (R. 95).

After their appointment, the receivers filed their first report, accompanied by an inventory of 235 pages, listing in minutest detail the debtor's assets (R. 122).

In January 1932, at the application of solicitors for the respondents (complainants below), in accordance with the accepted practice in the United States District Courts, a day was set for the final hearing on the bill and answer, the entry of a decree of sale of the debtor's property and the taking of testimony to fix an upset price (R. 673). This hearing was set for March 3, 1932, of which due notice was given to all parties of record (R. 670). Bankers Trust Company, as Trustee and judgment creditor for the sum of $11,674,240.21 (R. 432, 433), in respect of the principal and interest of the debtor's outstanding Debentures, had intervened January 9 (R. 141); The First National Bank of Cincinnati intervened March 3 (R. 155); and International Heater Company intervened March 31, 1932 (R. 200). Counsel for the petitioners attended this hearing but entered no appearance. At this hearing, voluminous testimony was taken of the appraisal and liquidating values of the debtor's property and of the wisdom and propriety of entering a decree of sale (R. 203, etc.). Both receivers testified at length and, exercising their proper function,

fully informed the Court as to the nature and value of the debtor's property which was in their custody. At the conclusion of this hearing the District Court took under advisement the entry of the decree of sale and after three months of further deliberation, on May 31, 1932, entered a decree directing the sale of the debtor's property (R. 420), with upset price fixed at $2,500,000 (R. 451). This sale was duly advertised and held and came on for confirmation at a further hearing on August 18, 1932, when the petitioners, then having intervened to oppose confirmation of such sale and to object to the terms of the Reorganization Plan (R. 722, 727), were heard (R. 579). The decree confirming the sale, from which they now appeal, was entered September 8, 1932 (R. 692).

The petitioners do not assert that the upset price fixed in the decree of sale was not fair or that the purchase price bid for the debtor's property was not adequate or that at the time of sale the debtor was able to pay its debts then due or was solvent in any sense of the word or that the sale of the debtor's property was not proper by way of equitable execution in satisfaction of such debts. Their petition questions neither the adequacy of the sale price nor the fairness of the Reorganization Plan, but the right of the District Court to have exercised jurisdiction (whether in the appointment of receivers in the first instance or in directing a sale of the debtor's property is not clear), because on the day the District Court took jurisdiction the debtor was solvent.

Whether the debtor was solvent or insolvent, in the sense of having assets in excess of liabilities, at the time of receivership, is primarily a question of fact. In the opinion of the District Court, $2,500,000 was considered

to reasonably represent "a minimum price for the properties of the defendant at which a sale of them might be confirmed" (R. 419). The Circuit Court of Appeals, after a study of the voluminous record in the Court below, said:

> "We have at much labor studied and absorbed this record. A recital of the mass of facts and figures would add nothing to the decision of the case. It will be sufficient to say that, notwithstanding what on first view is a startling disparity between book values and market values, we cannot find on the evidence that the learned judge erred in naming the price in the order of sale. If the upset price of $2,500,000 reflected the fair market value of the assets, we cannot find on the assignment charging error in confirming the sale that the purchase price of $2,550,000 was inadequate. At this figure, the purchase price was two per cent. above the upset price and ten per cent. above the highest price the evidence indicated as likely to be realized in liquidation.
>
> "The assignments charging error in the order of sale and the order of confirmation are dismissed."

The petitioners' assertion of a capital structure of $16,000,000 for the New Company is without support in the Record, since all shares of the New Company are without par value (R. 56) and the book value accorded the new Income Debentures has only remote relevancy in a valuation of the assets acquired by the New Company. Of no greater relevancy to a determination of the value of the debtor's assets is the 1927 book value of the debtor's outstanding securities. Even the book value attributed by the petitioners to the debtor's assets is not disclosed by the Record, for what are said to have been $18,000,000 of assets,

includes over $6,600,000 for good will (R. 782), over $6,300,000 for plants and equipment, as appraised *at replacement cost* as of December 31, 1926 (R. 368), less depreciation and increased by subsequent net additions at actual cost (shown to be salable on liquidation at not above $500,000) (R. 233) and other items of investment in affiliated companies and deferred charges. Cash was not "almost $2,000,000", but in fact 21% less, including Government certificates of indebtedness at cost (R. 782). The testimony showed that a substantial amount of this cash would be utilized in liquidating the debtor's slow assets (R. 234, 343, 383).

The $10,673,000 principal amount of the debtor's outstanding Debentures have been matured and are due and payable (R. 436), in accordance with their terms (which permit the acceleration of the maturity thereof after default in the payment of interest thereon (R. 36-37)). Interest and sinking fund charges alone overdue and unpaid on those Debentures amount to more than $2,600,000 (R. 35).

ARGUMENT.

The petitioners have not a vested right to preferential payment.

The real contention of the petitioners is that they should have been permitted to obtain the debtor's cash, leaving to other creditors the opportunity to take over the debtor's plants and slow assets. It would be regrettable were creditors unable to obtain equitable relief from the depredations of others until their common debtor has been denuded of

all current assets or at least cash or cash equivalent. Fortunately, such is not the law.

Michigan v. *Michigan Trust Co., Receiver* (1932), 286 U. S. 334;

In re Babcock (C. C. A. 7th Cir., 1928), 26 Fed. (2d) 153;

Kingsport Press, Inc. v. *Brief English Systems, Inc.* (C. C. A. 2nd Cir., 1931), 54 Fed. (2d) 497.

In the case last cited a consent receivership instituted by a number of creditors (situated as are the respondents' Reorganization Committee) and contested by a judgment creditor, who at the time of appointment of receivers was about to levy execution against the defendant's property, was sustained in an opinion of the Circuit Court of Appeals for the Second Circuit, delivered by Judge A. N. Hand, saying in part (at p. 501 of the Reporter):

> "The contention that the appointment was obtained by collusion is based on a confusion of ideas. It seems to be thought that it was illegal for the defendant to inform the complainant that Owen was ready to issue execution or to take any steps that would facilitate a receivership. We can discover nothing illegal in this. Owen had no vested right to prevent other creditors from being paid if an administration of the property of the defendant through an equity receivership would produce such a result though after some inconvenience and delay to himself."

From that decision, petition for writ of certiorari was denied, in (1931) 283 U. S. 858. It was cited with approval by this Court in

Shapiro v. *Wilgus* (1932), 287 U. S. 348, at 356.

In the instant case the receivership to all intents and purposes is concluded. The decree appointing receivers has been supplanted by the decree of sale and the decree confirming the sale of the debtor's property for the benefit of all creditors. Thus, this is precisely the type of equity proceeding which had Mr. Justice Cardozo's approval when he said:

> "It is one thing for a creditor with claims against a corporation that is legitimately his debtor to invoke the aid of equity to conserve the common fund for the benefit of himself and of the creditors at large. *Hollins* v. *Brierfield Coal & Iron Co.*, 150 U. S. 371, 380. Whatever hindrance and delay of suitors is involved in such a remedy may then be incidental and subsidiary." *Shapiro* v. *Wilgus* (1932), 287 U. S. 348, at 356.

The alternative urged by the petitioners would result in the recovery only by themselves, and those similarly minded, of payment in full of their claims, "while other creditors might have to go begging", as Judge Hand remarked.

The petitioners' entire argument rests upon their assertion that the debtor corporation is, or, at least, was, solvent and able to pay in full in cash its debts presently due and payable. Such in fact is far from the case. But even had the debtor been solvent at the time of its receivership, that fact would not have deprived the District Court of jurisdiction.

Superior Oil Corporation v. *Matlock* (C. C. A. 10th Cir., 1931), 47 Fed. (2d) 993;
Luhrig Collieries Co. v. *Interstate Coal & Dock Co.* (S. D. N. Y., 1922), 281 Fed. 265.

In the latter case Judge Learned Hand found that the defendant was solvent, but said (at page 269 of the Report):

> "While it is necessary to allege that the assets, if given no protection, will not be enough to pay all creditors, it is not necessary to allege that the corporation is presently insolvent, or even that, when properly managed, it will not have a surplus for distribution among stockholders; and for that reason it is not customary to allege insolvency, though it is customary more clearly than in the bill in suit to allege that the assets will not pay all, if abandoned to general waste by separate legal proceedings. Such bills may, of course, be abused by the collusion of the debtor and friendly creditors. They may be abused by the court's refusal to allow a present liquidation, disregarding the creditors' unqualified right to present payment, and preserving the property for the debtor, which is not entitled to more consideration than its creditors collectively think wise to give it. But that has nothing to do with the propriety of the bills as such; they form a necessary and important part of insolvency law, and are of unquestioned validity."

In the instant case the District Court, in its final decree of sale entered May 31, 1932, found that it had jurisdiction over all the parties to this cause and the subject matter (R. 420). In reviewing the decrees of the District Court, the Circuit Court of Appeals, in respect of the same questions now presented by the petitioners, rendered its opinion, stating in part:

> "The appellants' attack on the jurisdiction of the court to entertain the bill, appoint receivers and order a sale of assets as an entirety is disclosed by the three questions they have presented:

"(1) 'May a federal court of equity, in the absence of other equitable grounds, take jurisdiction of a foreign corporation which is solvent and able, in regular course, to pay its obligations in full, for the primary purpose of reorganizing it?'

"(2) 'May a federal court of equity, in the absence of other equitable grounds, and solely for the purpose of reorganizing a corporation which is not insolvent nor in imminence of insolvency appoint receivers to take possession of such corporation's property until it can be sold?'

"The plain answer to these questions is 'no'.

"The phrase 'in the absence of other equitable grounds' compels this answer because it excludes the essence of the court's jurisdiction in such matters. It is the presence of equitable grounds calling for relief in equity which gives the court jurisdiction. A court of equity is not a forum of convenience to be used by a corporation merely to straighten out its business difficulties or to rebuild its financial structure. Nor is it a place of refuge to which debtors may go for protection against their creditors and against the remedies of suit, judgment, execution and sale which the law affords them. Debtor corporations are not wards of chancery. There is nothing in the mere fact of a corporation's indebtedness, nor in its inability to pay, nor in its wish to make some composition with its creditors that confers equitable jurisdiction upon a court. It is only when there is something in a situation which sets up an equitable right and admits of equitable relief that parties may go into a court of equity and assert one and obtain the other. Common instances are where a corporation is insolvent or where its insolvency is imminent. Even in the latter case the right of a federal court of equity (cautiously exer-

cised) to appoint receivers at the instance of simple contract creditors if the debtor corporation consents, is not, as one of the appellants admits, debatable. *Michigan* v. *Michigan Trust Company,* 286 U. S. 334; *Shapiro* v. *Wilgus,* 287 U. S., p. 348.

"The appellants' third question, however, contains no nullifying exceptions and goes directly to the point. It is:

> "(3) 'Does the bill of complaint in the primary cause set forth facts sufficient to constitute a cause of action for the appointment of receivers or for other equitable relief?'

"The bill must, as we have stated, have equity, and equity will not lie in the mere fact, if such were the case, that the corporation could not pay interest. Here the corporation could presently pay, but payment foretold imminent consequences disastrous to the corporation and, what is more to the point, disastrous to its securityholders. Plainly those consequences were insolvency with its attendant evils to all concerned. The fact that the corporation had in hand sufficient money to meet certain current indebtedness did not alter the underlying conditions. *Continental & Commercial T. & S. Bank* v. *Allis-Chalmers Co.,* 200 Fed. 600, 613; *In re Babcock,* 26 Fed. (2d) 153. The facts of the situation, showing, as we find, imminence of insolvency and collapse, calling for protection of creditors, constituted a ground of equity for which relief could validly be asked by simple contract creditors within the law of *The Pusey & Jones Company* v. *Hanssen,* 261 U. S. 491 and within the warning of *Shapiro* v. *Wilgus,* 287 U. S., p. 348. The case therefore falls within the rule distinguished and succinctly stated by Judge Learned Hand in *Luhrig Colleries Co.* v. *Interstate Coal & Dock Co.,* 281 Fed. 265, 268, 269."

The fact that the Plan of Reorganization had been issued prior to the receivership presents no element of novelty in the instant case. Nor does the fact that the debtor's board of directors had in principle approved some form of reorganization. The normal eventual result of practically every equity receivership of a large corporation is reorganization. Every corporation which admits the allegations of the conventional creditors' bill and consents to the appointment of receivers knows that it is, in effect, consenting to a reorganization, which presumably will be dictated by its creditors and will involve a scaling down of fixed charges. In the ordinary case, it is true, the plan of reorganization has not been promulgated or even formulated at the time the creditors' bill is filed. The plan is always promulgated, however, before the entry of a final decree. It happens that in the instant case the Plan of Reorganization was promulgated before the creditors' bill was filed — but what possible bearing has this on the jurisdictional sufficiency of the creditors' bill? Is it conceivable that a general creditors' bill, which in the ordinary case would meet every test of legal sufficiency, becomes fatally defective simply because, prior to its filing, the overwhelming majority of the creditors have announced that they plan to effect a reorganization? In refutation of this suggestion, it is pertinent to quote the following language from the opinion of Judge Hough in *Conley* v. *International Pump Co.* (S. D. N. Y., 1915), 237 Fed. 286, at 288:

> "It is certainly a curious conception of practice which leads a small body of shareholders to seek to answer a foreclosure bill merely because they are dissatisfied with what the foreclosing complainant says out of court it hopes or even intends to do after the final decree is procured."

In the instant case, there has not been an abuse of jurisdiction, but an exercise of the orderly and equitable procedure established by an unbroken line of decisions of this Court. The petitioners' attempt must fail, to find in this case an analogy to the case of *Shapiro* v. *Wilgus*. In that case the defendant corporation was organized and one creditor brought suit for the sole purpose of holding the defendant's other creditors at bay. In the instant case, creditors holding more than 95% in amount of the defendant's indebtedness, not only in their own behalf but on behalf of all creditors similarly situated, instituted the receivership proceeding, to which the debtor consented, not as a means of holding creditors at bay, but as a voluntary surrender of possession of all of its property to judicially appointed custodians who could administer the same for the benefit of all creditors.

As among creditors of the same class, the petitioners have not a vested right to preferential payment. They may, with all other creditors, share in the ratable distribution of the net proceeds of the sale of the debtor's property. Or, if they believe the debtor's property to have potential worth not reflected by the purchase price thereof, since they do not assert that the Reorganization Plan is unfair as to them, they may unite in the reorganization and obtain the securities of the New Company, which in their market quotations should reflect the current value of the debtor's property, which the New Company acquires. They have in their petition advanced no reason, however, why they should fare better than all the other creditors of National Radiator Corporation, whose claims are not discharged "in full, in cash", in this receivership.

CONCLUSION.

The petition for writ of certiorari should be dismissed with cost.

Respectfully submitted,

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G. FRANKLIN LUDINGTON,

Counsel for Respondents RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS and FRANK B. CAHN, as the Reorganization Committee constituted under the Plan and Agreement dated February 11, 1931, for the Reorganization of National Radiator Corporation.